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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

QUARTER ENDED SEPTEMBER 30, 1988

PLEASE RETURN

MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

QUARTER ENDED SEPTEMBER 30, 1988

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APPOINTIVE OFFICIALS

Charles A. Brooke, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

		TERM EXPIRES
Spencer Hegstad, Chairman	Dillon	January 1, 1990
Pat DeVries	Polson	January 1, 1991
Jim Moore	Bozeman	January 1, 1990
William Ware	Helena	January 1, 1993
Rebecca Erickson	Glasgow	January 1, 1993

LOTTERY LIAISON COMMITTEE

Senator Larry Tveit	Fairview
Senator Larry Stimatz	Butte
Representative Budd Gould	Missoula
Representative John Vincent	Bozeman

REPORT DISTRIBUTION

According to Section 23-5-1007(7), MCA, copies of this report must be distributed to the following individuals.

Stan Stephens, Governor

Dave Ashley, Acting Director, Department of Administration

Scott Seacat, Legislative Auditor

Jack Galt, President of the Senate

John Vincent, Speaker of the House

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House requested this report be distributed to the Revenue Oversight Committee. In addition, the Speaker of the House requcsted this report be distributed to the House Business and Economic Development Committee.

Members of the Revenue Oversight Committee include:

Senators	Representatives
Bill Norman, Chairman	Susan Good, Vice Chairman
Bruce Crippen	Dan Harrington
Dorothy Eck	Robert Hoffman
Thomas Hager	Jim Patterson
Joe Mazurck	Ted Schye
Robert Brown	Robert Ream

The House Business and Economic Development Committee members include:

Represcntatives

Bob Pavlovich, Chairman	Gene DeMars, Vice Chairman
Fred Thomas	Bob Bachini
William Glaser	Thomas Nelson
Stella Jean Hansen	Lloyd "Mac" McCormick
Bruce Simon	Norm Wallin
Clyde Smith	Rob Blotkamp
John Johnson	Vernon Keller
Tom Kilpatrick	Don Stappler

Lottery
Montana
(406) 444-LUCK

May 1, 1989

To the Montana Lottery Commission:

For the quarter ended September 30, 1988, we recorded over $3.6 million in ticket sales, which is the same as the quarter ended June 30, 1988. This could be a sign of our revenues stabilizing, and a lottery ticket sales base developing.

It is, however, the first quarter in which we transferred less than $1 million to the State Superintendent of Public Instruction. This is due to a change in accounting policy as it relates to estimating ticket returns.

We did not estimate ticket returns when making our quarterly transfers in fiscal year 1988 because of a lack of historical data. However, now that there is actual data with which to measure returns, it has been established that we transferred $139,435 more in fiscal year 1988 than was required. This has resulted in a reduction of our transfer for this quarter ended September 30, 1988 of $139,435. More detailed information on this topic can be found in our June 30, 1988, audited financial report.

Annuities for our previous four jackpot winners were awarded this quarter to Western National Life through a formalized bidding process. However, the monies to pay for the annuities were not transferred this quarter. Therefore, no financial change related to annuities is reflected in this first quarter report.

In September the Big Spin ended its on-the-road tour and began its debut on television for the fall. The wheel itself was changed for the TV show with the jackpot capped at $1 million and all other cash prize amounts increased. These changes were made as a result of thousands of oral and written suggestions from lottery players across the state to "cap the jackpot" and put bigger cash prizes on the wheel.

2525 N. Montana, Helena, MT 59601-0542

During this quarter the Lottery placed over 400 dual lottery ticket dispensers at our lottery retailers. The dispensers attractively display two instant ticket games, giving players a visible reminder to buy lottery tickets at the point of purchase. Players may choose between games or buy both.

By continuing to listen to our retailers and players and using proven marketing techniques, we expect this will be another successful year.

Sincerely,

Charles A. Brooke
Director

cab/gjl

MONTANA LOTTERY
BALANCE SHEET
SEPTEMBER 30, 1988

ASSETS	(Unaudited)
Cash	$ 3,814,160
Receivables (Net)	324,266
Inventories	308,225
Equipment	730,671
Other Fixed Assets	4,093
Accumulated Depreciation	(155,440)
Intangible Assets	630,300
Other Assets	12,891
TOTAL ASSETS	$ 5,669,166

LIABILITIES AND FUND EQUITY	
Liabilities:	
Accounts Payable and Accruals	$ 215,013
Lottery Prizes Payable	3,638,090
Due to Other Funds (Note 2)	941,180
Installment Purchase/Lease Payable	472,798
Compensated Absences Payable (Note 1)	83,680
Allowance for Ticket Returns	318,405
	$ 5,669,166
FUND EQUITY:	
Retained Earnings Unreserved (Note 11)	-0-
Total Fund Equity	-0-
TOTAL LIABILITIES AND FUND EQUITY	$ 5,669,166

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
QUARTER ENDED SEPTEMBER 30, 1988

	Quarter ended September 30, 1988 (Unaudited)
OPERATING REVENUES:	
Charges for Service	
Net lottery ticket revenue	$ 3,675,094
License and permits	700
Total Operating Revenues	3,675,794
Prizes and Commissions	
Prize expense	(1,648,938)
Retailer commission	(205,775)
Net Operating Revenue	$ 1,821,081
OPERATING EXPENSES:	
Amortization	$ 42,020
Personal Services	242,151
Contractual Services	53,531
Cost of tickets sold	158,928
Audit Fees	10,743
Supplies and Materials	36,075
Depreciation	28,728
Utilities and Rent	23,135
Communications	16,590
Advertising	87,498
Travel	9,310
Repairs and Maintenance	17,230
Management Service Fee	16,336
Other	3,517
Total Operating Expense	$ 745,792
Operating Income	$ 1,075,289
NONOPERATING REVENUES (EXPENSES)	
Interest Expense	(260)
Total Nonoperating Revenues (Expense)	(260)
Income before Operating Transfers	1,075,029
Operating Transfers In (Out)	935,594
NET INCOME (LOSS)	$ (139,435)
Retained Earnings, Beginning of Period (Note 5)	$ (139,435)
RETAINED EARNINGS, END OF PERIOD	$ -0-

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
SEPTEMBER 30, 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-5-1001, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer regional lottery games and prepare financial reports.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund.

The Montana Lottery is classified as an Enterprise Fund of the governmental Proprietary Fund Type. Enterprise Funds account for operations a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Receivables. Receivables totalling $306,415 represent amounts owing the Lottery for purchased tickets. An allowance for doubtful accounts is usually based on historical perspective. Because of a limited historical perspective and immaterial uncollectible account balances, an allowance for doubtful accounts has not been established.

Receivables also include $17,554 in retailer commissions related to estimated ticket returns and $297 for a federal gas tax refund.

Inventories. Inventories consist of merchandise, Instabuck and supplies inventories. Merchandise inventory includes lottery tickets valued at $243,158 stored in the warehouse and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold when sold. After game end and awaiting disposal, unsold tickets are charged to cost of tickets sold.

Merchandise inventory includes a $7,641 adjustment related to estimated ticket returns.

Supplies inventories include paper supplies and point-of-sale materials having a value of $5,000 or more. At year end, supplies and Instabuck inventories totaled $65,067. These inventories are also recorded at cost using the specific identification method.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated to not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's payable for compensated balances is detailed below.

Balance June 30, 1988	Net Leave Earned/Used	Balance September 30, 1988
$74,705	$8,975	$83,680

Allowance for Ticket Returns. This allowance represents a liability as of September 30, 1988 for estimated ticket returns. Ticket sales have been reduced by approximately $27,000 for net estimated ticket returns for the quarter ended September 30, 1988. Prize expense has been adjusted by approximately $12,800. Commissions and cost of goods sold have also been adjusted for expenses associated with this allowance.

Revenue Recognition. Lottery ticket sales are recorded as revenue based on ticket deliveries to the retailers. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales have been reduced by an allowance for estimated ticket returns.

Free Tickets. The Montana Lottery's instant games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free tickets distributed approximated $426,297 for the quarter ended September 30, 1988.

Instabucks. Instabucks are a Lottery coupon good, upon redemption, for a lottery ticket. Instabucks, used to stimulate lottery ticket sales, are usually given away for promotions, retailer clerk incentive programs, and advertising trade-outs. The lottery tickets distributed resulting from Instabuck redemptions are reflected as a reduction in revenue. The related prize expense and ticket cost are reclassified as an advertising expense. For the quarter ended September 30, 1988, Instabuck redemptions resulted in a revenue reduction of $10,158 and a prize expense reclassification of $4,568.

Coupons. Occasionally, the Lottery promotes ticket sales by distributing coupons as matches for instant prizes. Cash prizes related to the coupons are included in the prize structure. Free ticket prizes awarded due to a coupon match are reflected as a reduction of revenue. For the quarter ended September 30, 1988, free ticket prizes awarded with a coupon match resulted in a revenue reduction of $3,928.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game. No prize expense is recorded for free tickets distributed.

Commissions. Retailers receive a five percent commission on tickets or chances sold. Commission expense is recorded based on the face value of tickets delivered to the retailers.

Amortization. The Instant Lottery System (ILS) software, classified as an intangible asset, is being amortized over a period of five years using the straight line method.

2. DUE TO OTHER FUNDS

The account "Due to Other Funds" totalling $941,180 reflects the $935,594 payable to the State Superintendent of Public Instruction and $5,586 due to other state agencies for goods and services provided through fiscal year end. The $935,594 transfer for the quarter ended September 30, 1988 will be paid to the State Superintendent of Public Instruction in May, 1989.

3. PAID PRIZES

Section 23-5-1027 MCA states "as near as possible to 45% of the money paid for tickets or chances must be paid as prize money".

For the quarter ended September 30, 1988, the prize expense of $1,648,938 reflects 44.87% of net ticket revenues totalling $3,675,094. From July 1, 1988 through September 30, 1988 prizes paid are detailed as follows:

High-tier	$ 169,688
Low-tier	1,025,143
Big Spin	196,000
	$1,390,831

High-tier prizes reflect prizes greater than $25 paid through Lottery headquarters. Low-tier prizes of $25 or less are paid by the retailer or Lottery headquarters.

4. TRANSFER TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

Section 23-5-1027, MCA states "that part of all gross revenue not used for payment of prizes, commissions, and operating expenses is net revenue and must be paid quarterly from the enterprise fund to the State Superintendent of Public Instruction for distribution as equalization aid to retirement funds..." For the quarter ended September 30, 1988, the net revenue amounted to $935,594. This amount will be transferred to the State Superintendent of Public Instruction in May, 1989.

5. DEFICIT RETAINED EARNINGS.

According to the law, the Lottery's net revenue must be transferred quarterly to the State Superintendent of Public Instruction. This transfer should result in a zero retained earnings balance. However, due to adjusting for the net

effect of estimated ticket returns and the recording of a fiscal year 1987-1988 expenditure after calculation of the transfer, the beginning retained earnings balance is ($139,435) rather than zero.

6. GAMES.

Currently, the Montana Lottery games are instant ticket games. These games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize. Players also have another chance to win by submitting five non-winning tickets or their promotional equivalent for the Big Spin drawing.

7. GAMING SUPPLIER CONTRACTS.

Tickets. On March 9, 1987, the Montana Lottery signed a one year contract with Scientific Games, Inc. to purchase lottery tickets. Under that contract, each instant ticket game consisted of 4,800,000 tickets or "other quantity as agreed by the parties."

This contract was extended until March 9, 1989 by letter dated February 23, 1988 and amended on May 5, 1988. The contract amendments address certain ticket specifications, price, and quantity. The amended minimum order quantity is 4,080,000 tickets.

The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure. Thc contract requires payment within 30 days of ticket receipt.

Scientific Games, Inc., as the vendor, delivered a $776,104 performance bond covering the contract term. The Company also provided an errors and omissions policy covering an ultimate net loss of $5,000,000.

This contract may be terminated when termination is in the best interest of the Lottery with proper notification to Scientific Games, Inc.

Computer Hardware and Software. The Lottery contracted with Scientific Games, Inc. on February 25, 1987, to purchase a used Stratus computer. The computer hardware and software cost $381,243. This contract also covered the acquisition of an Uninterruptable Power Supply (UPS) system for $40,551. The UPS system protects the computer against electrical power surges and failures.

The Lottery signed a separate agreement with Stratus Computer, Inc. on June 2, 1987, for maintenance of the Stratus computer hardware and software. Monthly maintenance totals $4,433.

On July 28, 1987, the Lottery signed a second agreement with Stratus Computer, Inc. regarding the Stratus software license. Under this contract, Stratus Computer, Inc. grants the Lottery a "nonexclusive, nontransferable license" to use the software of the Stratus computer. The proprietary rights and title of the software remain with Stratus Computer, Inc.

Training. The Montana Lottery contracted with Scientific Games, Inc. on January 15, 1987, to provide training and start-up assistance. This contract for $250,000 required quarterly payments of $62,500 due July 24, 1987, October 24, 1987, January 24, 1988, and April 24, 1988.

Lottery Software. On February 25, 1987, the Lottery agreed to purchase the instant Lottery System (ILS) software package for $840,400. This agreement provides the Lottery a "perpetual, non-exclusive, nontransferable license to use the software solely for the Lottery's own use". The contract allows the Lottery to make 36 monthly payments of $23,344.44 with no interest. The first payment was due June, 1987.

Lottery Consultant. On November 30, 1986, the Montana Department of Commerce contracted with Lottery Science, Inc. for lottery consultant services. These services included organization structure, facility specifications, timetables, game implementation plans, and other recommendations. These services were required due to the July 1, 1987 mandate for an operational lottery.

The contract, covering the period from November 30, 1986 to February 28, 1987, provided for payment of $58.14 per hour not to exceed $30,000, $100 per diem while in Helena, and travel expense reimbursement.

Lottery Consultant. The Montana Lottery contracted with Gaming Dimensions, Inc. on February 27, 1987 for consultant services. These services included timetable development, fiscal and legislative recommendations, security system design, sales structure, and game implementation plans. These services were obtained due to the unexpected death of the consultant associated with Lottery Science, Inc. The contract terms provide for payment of services at $58.14 per hour, $100 per diem while in Helena, and reimbursement of travel expenses.

This contract was amended on June 1, 1987. The consultant's work was redefined to develop a test of the lottery system software, provide advice on start-up and adequacy of training, and prepare a report on the feasibility of an on-line game and regional lotteries. The amended contract provides for payment of the consultant at $58.14 per hour for a maximum of 160 hours per month, $50 per diem while in Helena, and travel expense reimbursement. The contract expired on December 31, 1987.

8. SUBSEQUENT EVENTS

On July 21, 1988, the Lottery paid $1,232,477 for the quarter ended June 30, 1988 to the State Superintendent of Public Instruction. First year Lottery transfers amounting to $8,375,894 were distributed to eligible counties by the State Superintendent of Public Instruction in September 1988.

On September 26, 1988, the Montana Lottery awarded annuities amounting to $2,350,180 from Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. The Lottery will be contingently liable for the remaining prize payments.

OTHER

INFORMATION

MONTANA LOTTERY
SUMMARY OF FINANCIAL DISTRIBUTION
(UNAUDITED)
QUARTER ENDED SEPTEMBER 30, 1988

COMMISSIONS - Section 23-5-1016(10), MCA provides retailers a 5% commission on tickets or chances sold. The commission on tickets sold to the retailer gives the retailer $25 per book of 500 tickets. The 5% commission of $205,775 for the quarter ended September 30, 1988 is based on gross lottery ticket sales of $4,115,477.

OPERATING EXPENSES - The Lottery, according to Section 23-5-1027(2), MCA, is allowed "up to 15% of gross revenue for operating expenses." Gross revenue includes net lottery ticket revenue and license fees. While retailer commissions, by law, are not considered an operating expense, interest expense is considered an operating expense for this purpose. The operating expense percentage for the quarter ended September 30, 1988, using the accrual basis of accounting, is as follows:

	Quarter ended September 30, 1988 (Unaudited)
Net lottery ticket revenue	$ 3,675,094
License and permits	700
Total Gross Revenue	$ 3,675,794
Operating expenses	$ 745,792
Interest expense	260
Total Operating Expense	$ 746,052
Operating expense percentage	20.30%

Due to increased or decreased financial activity within a quarter, the operating expense percentage will fluctuate above or below the mandated 15% of gross revenue between quarters. However, operating expenses, as determined by the state budgeting process, by law, must be 15% or less of gross revenue over a fiscal year's time.

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION TRANSFER - The funds transferred to the State Superintendent of Public Instruction, by law, are not based on a percentage of revenue. The distribution is based on a definition of net revenue. Net revenue is that part of all gross revenue not used for the payment of prizes, commissions, and operating expenses. Net revenue for the quarter ended September 30, 1988 is detailed below:

	Quarter ended September 30, 1988 (Unaudited)
Income before Operating Transfers	$1,075,029
Retained Earnings, Beginning of Period	(139,435)
Net Revenue Transferred to State Superintendent of Public Instruction	$ 935,594

PRIZES - Section 23-5-1027(1a) states "as near as possible to 45% of the money paid for tickets or chances must be paid out as prize money..."

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the quarter ended September 30, 1988, the prize expense of $1,648,938 is 44.87% of the net Lottery revenue of $3,675,094.

When recording the prize expense, a corresponding liability for high-tier and Big Spin prizes is also recorded. The relationship between prize expense, prizes paid and the change within prize liability is illustrated below:

July 1, through September 30, 1988		Percent of Net Lottery Ticket Revenue (Unaudited)
Prizes paid	$1,390,831	37.85%
Instabucks	(4,568)	(.12)
Increase (decrease) in prize liability	262,675	7.14
Prize expense	$1,648,938	44.86%

The prizes paid percentage is less than the mandated 45% due to the increase in unclaimed prizes and the yet to be purchased annuities for the Jackpot prizes. If these prizes are unclaimed within six months after game end, the remaining funds become available for prizes in other games.